ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Leno	Analyst:	Jane Tolman	Bill Number:	AB 2303
Related Bills:	No Legislative History	Telephone:	845-6111	Amended Date:	April 15, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Business Expense Deduction/None Allowed For Costs Paid Or Incurred By Public Utility For Any Bonus Paid To Executive Officer During Period Utility Is Insolvent

SUMMARY

This bill would prohibit deductions for bonuses paid to an executive officer of a public utility if the public utility is insolvent.

SUMMARY OF AMENDMENTS

The April 15, 2004, amendments change the language regarding bonuses that would not be deductible as a business expense. The amendment also corrected a technical error.

The Public Utilities Code provisions of this bill would not impact the department and are not discussed in this analysis.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

It appears the purpose of this bill is to prevent a public utility from passing to consumers the expense of bonuses paid to executives while the utility is insolvent.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2005, and would apply to taxable years beginning on or after that date.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Under current federal and state income tax law compensation means wages, salaries, commission and any other form of remuneration paid to employees for personal service. A publicly held corporation is not allowed to deduct employee remuneration paid to certain employees in excess of $1 million per year. Remuneration would include such things as bonuses.

Board Position:			Department Director	Date
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_______ N	_______ OUA	___X___ PENDING		

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business, including wages, salary, commission, and bonuses.

THIS BILL

This bill would prevent an insolvent public utility company from deducting the costs paid or incurred for bonuses issued to an executive officer.

For purposes of this bill, an "executive officer" would mean a person employed by the public utility who performs policy-making functions. It includes the president, secretary, treasurer, and any vice president in charge of a principal business unit, division, or function of the public utility.

For purposes of this bill, "insolvent" would mean a public utility that has ceased to pay its debts in the ordinary course of business, cannot pay its debts as they become due, or its liabilities exceed its assets.

This bill would not apply to employee bonuses that are part of a standard compensation contract.

IMPLEMENTATION CONSIDERATIONS

This bill uses the term "standard compensation contract," but does not provide a definition. The lack of a definition to clarify this term could be confusing for the taxpayer and the department.

It is not clear if all bonuses during a given year would be nondeductible if the public utility has more liabilities than assets. Further, the treatment of a public utility that was solvent before paying the bonus, but became insolvent after paying the bonus is not clear.

If this bill were amended to resolve these implementation considerations, this bill would not significantly impact the department's programs and operations.

OTHER STATES' INFORMATION

Illinois, Massachusetts, Michigan, *Minnesota*, and *New York* laws were reviewed because of the similarities between California income tax laws and their tax laws. These states treat remuneration in the same manner as California allowing the taxpayer to deduct as a business expense. No information was found specific to insolvent public utilities and the denial of bonuses as a business deduction.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would have the estimated following revenue effects:

Estimated Revenue Impact of AB 2303 As Introduced February 19, 2004 Effective for tax years BOA 1/1/2004 Enacted after 6/30/2004 $ Millions		
2004-05	2005-06	2006-07
Negligible gain*	Negligible gain*	Negligible gain*

* Negligible is less than $250,000.

This estimate does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

This bill would have a negligible revenue impact. Public utilities are now less likely to become insolvent. The few cases in 2001 were caused by the state electricity crisis, which is unlikely to be repeated in the next few years. Even if some public utilities become insolvent in the next few years, the average amount of bonuses paid may be significantly less than in prior years due to the constraining effects of recent corporate/executive scandals in general. The revenue gains of this proposal are projected as follows:

Assuming that (1) the bonus amount awarded to officers and employees in any given year is $5 million, (2) the average tax rate is 8.84%, and (3) the average apportioning factor would be 33%, the tax revenue gain for the tax year 2005 would be:

($5,000,000)(0.0884)(0.33) = $150,000

ARGUMENTS/POLICY CONCERNS

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

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